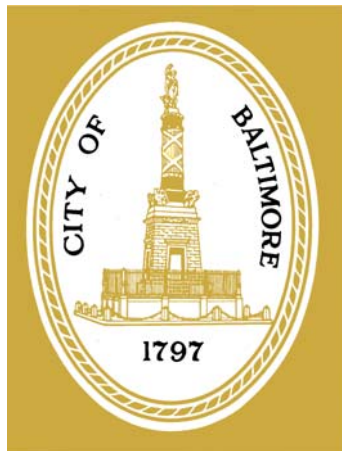


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**Review of**  
**Water and Waste Water**  
**Proposed Rate Increases**  
**Effective April 11, 2002**

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City of Baltimore  
Department of Audits

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## CITY OF BALTIMORE

MARTIN O'MALLEY, Mayor



## DEPARTMENT OF AUDITS

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April 4, 2002

Honorable Joan M. Pratt, Comptroller  
And Other Members of the Board of Estimates  
City of Baltimore

At the request of the City Comptroller, we reviewed the methodology and procedures used to determine the proposed 16% Water and 10% Waste Water rate increases submitted for the Board of Estimates' approval by the Department of Public Works (DPW) and Director of Finance. The effective date of the proposed rate increases is April 11, 2002. The purpose of our review was to determine whether the methodology and procedures used were appropriate and whether the applicable computations were accurate.

As required by the December 1978 Charter Amendment, the City Council adopted Ordinance 941 which established, among other things, a mechanism for the determination of rates and charges for water and waste water services. Ordinance 941 requires that the City's Water and Waste Water Utility Funds (Utilities) establish rates or adjust rates to make the Utilities self-supporting (e.g., when a loss is projected for the current fiscal year and the immediate fiscal year resulted in a loss). Ordinance 941 also requires that the rates be established at a level sufficient to recover any accumulated deficit from prior years. Additionally, the Utilities must comply with revenue bond covenants that cover the utility rates.

The City is negotiating with the U.S. Environmental Protection Agency and the Justice Department on a combined sewer overflow Consent Decree to update its Waste Water System. As part of the Consent Decree, the City must significantly increase and accelerate its existing Capital Improvement Program (CIP) for the Waste Water System. In order to cost-effectively meet the terms of the Consent Decree, fund other Water and Waste Water CIP projects and minimize projected customer rates, the City has developed a comprehensive multi-year plan of finance to modernize and strengthen bond covenants. The City also expects to restructure debt to help fund the CIP on an affordable basis.

In order to determine the need for the proposed rate increases, Utilities personnel prepared a comprehensive financial model that projects revenues, expenditures, cash balances and reserves for fiscal years 2002 and 2003. The projected revenue requirements and proposed rate increases are based upon expected CIP projects, sources of funds and new legal covenants. The proposed 16% Water and 10% Waste Water rate increases will increase revenues for fiscal year 2003 by \$7.5 million and \$6.6 million for the Water and Waste Water Funds, respectively. The proposed rate increases provide more reserve funds than required to meet expected legal covenants and

required bond coverage through fiscal year 2003. However, according to Utilities personnel, the additional reserve funds make the Utilities' revenue bonds more attractive to investors, resulting in favorable interest rates when bonds are sold. Also, the additional reserve funds will be utilized in subsequent years to ensure moderate and predictable rate increases rather than large, one-time rate increases. Based upon the comprehensive financial model, annual rate increases for the Utilities for fiscal years 2004 through 2008 are expected to be in the range of 8% to 9%.

Based on our review of the methodology and procedures used to calculate the proposed rate increases and our review of the documents and schedules prepared by DPW to support the projections of revenues, expenditures, cash balances and reserves, we verified that the proposed rate increases are needed to keep the Utility Funds self-sustaining and to provide adequate cash reserves for the planned new bond covenants and future capital expansion.

Respectfully submitted,

Yovonda D. Brooks, CPA  
City Auditor